

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

[Third Party Communication:

Date of Communication: Month DD, YYYY]

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PLR-144961-08

Date:

February 11, 2009

LEGEND

Trust =

Plan =

Retirement Plan =

Dear :

This is in reply to your letter dated October 10, 2008, requesting rulings that the income of Trust is excluded from gross income under § 115(1) of the Internal Revenue Code and that Trust is not required to file a federal income tax return.

FACTS

State established Plan to pre-fund medical benefits for public employees who participate in State's defined benefit retirement plans. Plan's sole purpose is to assist State in providing medical benefits to eligible retirees, their spouses, dependents and domestic partners. Plan provides benefits through a self-insurance arrangement. Benefits provided under Plan include medical and prescription drug benefits.

State created Trust as a vehicle to pre-fund benefits provided under Plan. Trust will accept, account for and invest the contributions made by participating employers in Plan. Trust proposes to amend its trust agreement to clarify that only an employer that

is a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under section 115 may become a participating employer.

Trust is governed by the same board of trustees (Board) that governs the State retirement system. Board consists of nine trustees. Two trustees are State officials. Two trustees are selected from the general public by the State governor. The remaining five trustees are also selected by the governor and include employees, former employees and elected or appointed officials of participating employers.

The income of Trust is derived from employer contributions and investment income. Trust's assets are held in Trust for the exclusive purpose of providing post-employment health care benefits to the employees of the participating employers and defraying the reasonable expenses of administering Trust. Trust proposes to amend the trust agreement to provide that no part of Trust's net earnings may inure to the benefit of a private person and that private parties do not participate in or benefit from the operation of Trust.

Benefits will not be paid by pre-tax salary reduction. Plan does not provide for any cash-out of unused benefits and is not funded by any conversion of sick or vacation days to post-retirement health benefits. In addition, reasonable efforts will be made to identify individuals who do not qualify as a spouse or dependent (under section 152 of the Code) of a retiree who participates in Plan. Any income relating to the coverage of such individuals will be imputed in the income of the retiree.

The trustees may amend Trust at any time. Trust proposes to amend the trust agreement to provide that in the event Trust is dissolved the trustees will distribute the assets of Trust solely for the purpose of assisting in the payment of medical benefits for the participants and their eligible spouses and dependents and for related administrative expenses. Trust further represents that it will amend the trust agreement to provide that in no event will any Trust assets be transferred to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under § 115(1) of the Code.

Trust proposes to add the following statement to the first page of the trust agreement:

"The Trust provides no guaranty that payments or reimbursements to employees, former employees, retirees, spouses or beneficiaries will be tax-free. The Trust has obtained a ruling from the Internal Revenue Service concerning only the federal tax treatment of the Trust's income. That ruling may not be cited or relied upon by the Employer whatsoever as precedent concerning any matter relating to the Employer's health plan(s) (including post-retirement health plans). In particular, that ruling has no effect on whether contributions to the Employer's health plan(s) or payments from the Employer's health plans (including reimbursements of medical expenses) are excludable from the gross income of employees, former employees or retirees, under

the Internal Revenue Code. The federal income tax consequences to employees, former employees and retirees depend on the terms and operation of the Employer's health plan(s)."

LAW & ANALYSIS

Section 115

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides health benefits to retired employees of the participating employers. Each of Trust's participating employers is required to be a state, a political subdivision of a state or an entity the income of which is excluded from gross income under § 115(1) of the Code. Providing health benefits to current and former public employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to its participating employers, each of which is a state, a political subdivision of a state or an entity the income of which is excluded from gross income under § 115(1) of the Code. No private interests participate in or benefit from the operation of Trust other than as providers of goods and services. Upon termination of Trust its remaining assets will be distributed to fulfill an obligation assumed by the participating employers with respect to providing health benefits to their employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Ru. 90-74. In no case will Trust assets be distributed to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under section 115 of the Code.

Based on the information and representations submitted by Trust, we hold that, as of the date the amendments described above are adopted, the income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.

Section 6012

Section 6012(a)(2) and Treas. Reg. § 1.6012-2(a)(1) of the regulations provide, in part, that every corporation, as defined in § 7701(a)(3), subject to taxation under subtitle A is required to file an income tax return regardless of whether it has taxable income or regardless of the amount of its gross income.

Section 6012(a)(4) provides that every trust having for the taxable year any taxable income or having gross income of \$600 or over, regardless of the amount of taxable income, must file an annual income tax return. Section 7701(a) and § 301.7701-4 of the regulations define trust for purposes of § 6012.

If Trust is classified as a trust for federal income tax purposes, no annual income tax return is required to be filed by Trust pursuant to § 6012(a)(4) since any income realized by Trust is excluded from gross income under § 115(1). However, if Trust is a corporation, as defined in § 7701(a) (3), it will be required to file an income tax return pursuant to § 6012(a)(2).

No opinion is expressed on the classification of Trust as a trust or corporation for federal tax purposes. No opinion is expressed concerning the federal tax consequences of Trust under any other provision of the Code other than those cited above. In particular, no representation is made that contributions to Plan or payments to employees, former employees, retirees, spouses or beneficiaries will be tax-free. The Trust has obtained a ruling concerning only the federal tax treatment of the Trust's income. That ruling may not be cited or relied upon whatsoever as precedent concerning any matter relating to Plan. In particular, that ruling has no effect on whether contributions to Plan or payments from Plan (including reimbursements of medical expenses) are excludable

from the gross income of employees, former employees or retirees, under the Internal Revenue Code. The federal income tax consequences to employees, former employees and retirees depend on the terms and operation of Plan.

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your representative.

Sincerely,

Sylvia F. Hunt
Assistant Chief, Exempt Organizations
Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter
Copy for § 6110 purposes